

**READING BOROUGH COUNCIL
REPORT BY HEAD OF FINANCE**

TO:	AUDIT & GOVERNANCE COMMITTEE		
DATE:	17 November 2016	AGENDA ITEM:	3 (Updated)
TITLE:	APPROVAL OF 2015/16 ACCOUNTS, EY AUDIT MEMORANDUM & AUDIT OPINION (ISA260)		
LEAD COUNCILLOR:	CLLR STEVENS	AREA COVERED:	CHAIR OF AUDIT & GOVERNANCE
SERVICE:	FINANCIAL	WARDS:	BOROUGHWIDE
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JOB TITLE:	HEAD OF FINANCE	E-MAIL:	Alan.Cross@reading.gov.uk

1. PURPOSE AND SUMMARY OF REPORT

- 1.1 In accordance with the Accounts & Audit Regulations, the Committee, on behalf of Council is required to approve the Council's accounts.
- 1.2 Ordinarily, this should occur by the end of September, but the Committee will know that at that meeting the Auditor indicated that she was not in a position to conclude the audit, and indeed was considering the possibility of needing to issue a qualified opinion on the accounts.
- 1.3 As part of the annual external audit process of the Council's accounts, EY produce an Audit Memorandum (ISA260) to those charged with Governance prior to issuing their opinion.
- 1.4 Since September, the technical finance team have done a significant amount of work to respond to EY's outstanding queries, such that in the first week of November the auditor provisionally indicated that subject to EY's final checks and the approval of the accounts by the Committee, the receipt by them of a Management Representation letter, the receipt by the Committee of the Report to those Charged with Governance they will be in a position to issue an unqualified audit report on the (amended) Council's accounts, thus concluding the accounts audit process for 2015/16. This report sets out these documents, though for reasons of size (over 100 pages) the formal accounts have not been printed as part of the agenda. A copy can be printed for any councillor who wishes to have one.
- 1.5 EY are separately required to issue a value for money opinion, that includes factors related to financial stability. EY continue to indicate that this opinion will be qualified.

1.6 EY will be present at the meeting to deal with questions relating to their audit.

2. RECOMMENDATION

2.1 Audit & Governance Committee are requested to note:

- a) the Management Representations letter from the Finance Director and Head of Finance
- b) EY's (ISA 260) Report to those charged with governance (to follow)

2.2 Audit & Governance Committee are requested, on behalf of Council to approve the final accounts for 2015/16, noting that in doing so EY will be in a position to issue an unqualified opinion on the accounts.

2.3 Audit & Governance Committee are requested to note the qualified VFM opinion and actions the Council has agreed to pursue arising from the audit on behalf of Council (as set out in Section 4.3).

3. POLICY CONTEXT

3.1 Each year as part of the annual external audit process the Council's External Auditor produce a report addressed to those charged with governance prior to issuing their Audit Opinion. This is the first year of EY's appointment as auditor.

3.2 EY's report is submitted to the Audit & Governance Committee as part of its duties on behalf of Council.

3.3 However, given the democratic nature of the Council it is possibly too simplistic to suggest the Committee is solely responsible for governance, and we suggest that Council as a whole as well as the Administration have some governance responsibilities too, as of course does the Corporate Management Team. To reflect the is, the Council's Annual Governance Report is signed by the Leader and Managing Director.

3.4 The general financial position at the end of the 2015/16 financial year was reported to the Committee at its July meeting, and the Council's draft accounts were signed off at the end of June by the Head of Finance and placed on the website. As is normal in the course of the audit we have agreed various changes to the draft accounts in discussion with the auditor. This year the number of changes has been somewhat larger than usual, and whilst many of them are arguably somewhat technical, in the usable resources of the Council (i.e. the General Fund, HRA, Reserves and Capital Receipts Balances) have not changed following audit, some of them might be seen as more significant. Paragraph 4.6

outlines the key changes, and some of them are also (to be) referred to in EY's report.

- 3.5 As part of the process, the Council's Section 151 Officer is required to submit a Management Representations letter to the External Auditor, and this is attached for the information of the Committee. EY have asked that the Chair of the Committee acknowledge that the committee have seen this.

4. OPINION AND AUDIT MEMORANDUM / MANAGEMENT REPRESENTATIONS LETTER

- 4.1 Attached to this covering report are
- Appendix 1 - Management Representations Letter
 - Appendix 2 - EY's Audit Memorandum (ISA 260)

4.2 Implementing External Audit Recommendations

EY's letter includes recommendations, and these are set out as follows

(i) We recommend that the Council retain documentation supporting judgements around material items and accounting treatments in an accessible form. This would reduce the inefficiencies experienced when this wasn't forthcoming and could protect the Council from challenge if documentation supporting those judgements is not retained. The time taken to resolve queries and re-validate policies going forward can be costly if a formal audit trail is not retained.

(ii) We recommend that the Council complete all financial reconciliations on a regular basis and that these are reviewed and reported on to the Head of Finance for final review and sign off. Doing this with will help improve the financial management of the Council.

(iii) We were unable to gain sufficient assurance from our work to enable us to rely on the controls within Academy. Our findings were discussed and agreed with the Council and an action plan agreed we will follow up progress on the action plan in our 2016/17 audit.

(iv) We recommend that the composition of the Committee is reviewed.

(v) We recommend that prompt action is taken to respond to (such) requests {related to public inspection} and that the initial response should be delegated to allow the response to be reviewed by a senior manager.

4.3 Responses to Recommendations

Our suggested responses are

- (i) In principle agreed. The Council does retain documentation. However, we did not anticipate that we would need to produce documentation originally prepared 6, c.10 & 18 years ago for this audit, that in practice is not needed on a day to day basis. Inevitably older documentation much less frequently used may often be harder to locate.
- (ii) Agreed. We have set out for EY a structured process designed to bring the main bank reconciliation back into balance (writing off unreconciled immaterial historic differences). A range of other system reconciliation controls have also recently been improved.
- (iii) As indicated, the recommendations here have already been agreed and are being progressed
- (iv) This is a matter for Councillors to decide. The recommendation is in accordance with published guidance in this area.
- (v) Agreed. There was an unusual delay in dealing with this query because of overall work pressures. It was delegated.

In addition, recognising the auditor's comments in relation to the S106 Fraud, as part of Audit Planning, the Chief Auditor proposes to undertake a high level fraud risk assessment

4.4 Reasons for Delay in Audit Opinion

As the auditor explained to the committee EY were unable to conclude their work in line with the statutory September deadline. There were various reasons for this

- (i) EY were new so needed to check more things in this audit than the previous auditor would have normally done on an annual basis (or we anticipate EY may need to do in future years). Whilst this was to be expected, the extent of queries arising was much greater than we had expected or were resourced to deal with.
- (ii) The consequence of this tended to be that responses were slow, as the capacity to deal with audit questions was largely in line with the experience of many years with KPMG. In some cases audit queries included asking the Council for evidence that will have been made available to KPMG in past audits (5/6 years ago and in at least one case going back to Local Government Reorganisation 18 years ago). We also experienced some staff changes within the team during the course of the audit, which reduced our capacity to respond to queries.
- (iii) In addition, given the financial challenges the Council faces the Finance Team has had to focus its time on assessing the financial position, and enabling the Corporate Management Team and Councillors have the right information to manage the Council's budget going forward.

- (iv) Furthermore, as explained by the Chief Auditor in his quarterly report in September 2015, “the internal audit team have been requested by the Council’s Corporate Management Team to undertake some targeted reviews to ensure proper processes are being followed and the Council can demonstrate it is spending appropriately.” Whilst the Chief Auditor was also able to say that “the requested work will still require the control environment and governance process to be evaluated”, thus he was “satisfied that sufficient Internal Audit work will have been undertaken to allow me to draw a reasonable conclusion as to the adequacy and effectiveness of the Council’s risk management, internal control and governance processes at financial year ending the 31 March 2016, the consequence of this change in focus on audit work was that less time than normal was spent on Key Financial Systems, so EY were not able to rely on Internal Audit’s work in the same way KPMG have been in recent years so did more work themselves.
- (v) The preparation of the accounts in June was impacted by the resource issues set out at (iii) with the consequence that some of the work was completed quite late before the June deadline, and checked less. Following on from this, and recognising that in some cases EY felt a different technical accounting approach was more appropriate than that which has been historically used, leading to more adjustments. It has taken time to process the adjustments and agree a final “true and fair” set of accounts with EY.
- (vi) Also, whilst we provided EY with working papers at the beginning of their audit, as we understood their needs. In some cases these did not meet their requirements, and we could have done more at the outset to have recognised and better understood what they needed, to enable an efficient audit. We would anticipate that our experience over the past few weeks has shown us much more clearly the information EY need in future years, and we will be discussing this with them in a post audit review meeting how we can better provide the information they need that is consistent with our approach to preparing the accounts (to minimize the number of papers that have to be prepared solely for EY).

4.4 As a consequence, the audit has been far from normal and taken much longer to complete, though as indicated above, there have been no changes to the council’s available usable balances and resources as a consequence of EY’s audit so from a future financial planning point of view, the late conclusion of the audit has not altered the underlying fundamental financial position.

4.5 Changes since June/September and EY Audit Differences

Comparing the draft accounts published in June (which had not changed at the time of the September Committee) with the final draft being presented to committee for approval identifies the following adjustments

- a) A change in the movement in unusable reserves of £8.5m reducing them from £186.2m to £177.7m
- b) Prepayments by us of £3.3m had been netted off creditors, but should have been shown within debtors.
- c) A reduction in Long Term Debtors from £14.5m to £9.3m to reflect the removal of a “future land sale” as the land in question had been made available (without financial consideration) to enable a new school to be constructed as part of a development. As the property in question had previously been carried as an investment property, its disposal is reflected by a loss on disposal in the Income & Expenditure Account. (This is largest single item impacting a) above)
- d) An increase in the cash and cash equivalents from £1.76m to £8.32m, largely matched by a reduction in short term creditors, but also some increase in debtors and deferred income.
- e) A reduction in our long term PFI liabilities - In particular, in reviewing the note on the HRA housing scheme with EY, it was appropriate to recast the note as it became apparent that it had not been fully updated since this accounting requirement to bring PFI schemes on balance sheet was introduced about 6 years ago, and the likely longer term liability was overstated.
- f) Updating of future capital commitments in note 21 (that had not been updated from the 31/3/15 position) reducing it from £55m to £17.7m.
- g) Updating of the note on the Equal Pay Back Pay Provision to more fairly reflect the current position.

In total 11 adjustments were made to the accounts, summarised as above.

4.6 EY

The committee will be aware that prior to its abolition the Audit Commission decided to appoint EY as auditor for the 2015/16 & 2016/17 accounts. We are currently being consulted by PSAA on the extension of EY's appointment to include the 2017/18 audit.

5. FINANCIAL IMPLICATIONS

- 5.1 As was indicated by the Auditor to the Committee in September because EY's work has overrun, there will be an additional fee. At the time of despatch the fee had not been agreed, but should be set out in EY's report.

5.2 As indicated above and in EY's report, a number of adjustments have been made to the accounts since June, but overall these has not been an impact on the General Fund Balance or other usable resources.

5.3 The final accounts with the audit report will as usual be published on the Council's website.

6. LEGAL IMPLICATIONS

6.1 Whilst the process being followed is aligned with the general requirements of the Accounts & Audit Regulations, the Council has not been able to comply with the requirement to publish final audited accounts by 30 September because of the delay in concluding the audit.

7. CONTRIBUTION TO STRATEGIC AIMS / COMMUNITY ENGAGEMENT /EQUALITY IMPACT ASSESSMENT

7.1 Notwithstanding the non compliance with regulation set out above, inasmuch as over the 6 weeks since the September meeting we have been able to work with the auditor to enable her to provide an unqualified opinion on the accounts contributes to the Council's aim to be financial stable.

8. BACKGROUND PAPERS

8.1 Audit Working papers (save confidential/personally sensitive material)

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Interim Managing Director

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17 November 2016

┌
Maria Grindley, Executive Director
EY LLP
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Forbury Road
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RG1 1YE
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Your contact is:

Alan Cross, Head of Finance, Financial Services

Dear Maria,

LETTER OF REPRESENTATION 2016/17 AUDIT

This letter of representations is provided in connection with your audit of the financial statements of Reading Borough Council ("the Group and Council") for the year ended 31 March 2016. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the financial statements give a true and fair view of the Group and Council financial position of Reading Borough Council as of 31 March 2016 and of its income and expenditure for the year then ended in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

We understand that the purpose of your audit of our consolidated and Council financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK and Ireland), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

A. Financial Statements and Financial Records

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements for the Group and the Council in accordance with the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 (save that we have been unable to publish audited accounts by 30 September).

2. We acknowledge, as members of the Corporate Management Team of the Council, our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above (as amended following audit) give a true and fair view of the financial position, financial performance and cash flows of the Council in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16. The Council's Audit & Governance Committee has approved the financial statements on behalf of Council.

3. The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.

4. As members of the Corporate Management Team of the Council (with oversight of the Group), we believe that the Group and Council has systems of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16, that are free from material misstatement, whether due to fraud or error.

5. We believe that the effects of the unadjusted audit difference the overstatement in Note 18 of the short term accumulated absence account, summarised in the accompanying schedule, accumulated by you during the current audit is immaterial, both individually and in the aggregate, to the financial statements taken as a whole. We have not corrected the difference identified by and brought to the attention from the auditor because this would necessitate a large number of quite small accounting entries in the underlying records and detailed statement that would be excessively time consuming to implement at this stage.

B. Fraud

1. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.

2. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

3. We have disclosed to you all significant facts relating to any frauds, suspected frauds or allegations of fraud known to us that may have affected the Group or Council (regardless of the source or form and including, without limitation, allegations by "whistle-blowers"), whether involving management or employees who have significant roles in internal control. Similarly, we have disclosed to you our knowledge of frauds or suspected frauds affecting the entity involving others where the fraud could have a material effect on the financial

statements. We have also disclosed to you all information in relation to any allegations of fraud or suspected fraud communicated by employees, former employees, analysts, regulators or others, that could affect the consolidated or Council financial statements.

C. Compliance with Laws and Regulations

1. We have disclosed to you all identified or suspected non-compliance with laws and regulations whose effects should be considered when preparing the consolidated and council financial statements.

D. Information Provided and Completeness of Information and Transactions

1. We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

2. All material transactions have been recorded in the accounting records and are reflected in the financial statements.

3. We have made available to you all minutes of the meetings of the Council and committees and summaries of actions of recent meetings for which minutes have not yet been prepared held through the 1 April 2015 to the most recent meeting (of Council) on the 18 October 2016.

4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Group and Council's related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the period end. These transactions have been appropriately accounted for and disclosed in the consolidated and council financial statements.

5. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.

6. We have disclosed to you, and the Group and Council has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

E. Liabilities and Contingencies

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the financial statements.
2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent and no other claims in connection with litigation have been or are expected to be received.

F. Subsequent Events

1. Other than the one school converting to academy status described in Note 24 to the financial statements, there have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto.

G. Group audits

1. There are some restrictions on our ability to direct the bus company (the material Group entity) as set out in legislation and it operates at arm's length from the Council. Otherwise there are no statutory, contractual, or other restrictions other than those indicated in the Group and Council financial statements.
2. Necessary adjustments have been made to eliminate all material intra-group unrealised profits on transactions amongst council, subsidiary undertakings and associated undertakings.

H. Ownership of Assets

1. Except for assets capitalised under finance leases, the Group and Council has satisfactory title to all assets appearing in the balance sheets, and there are no liens or encumbrances on the Group and Council's assets, nor has any asset been pledged as collateral. All assets to which the Group and Council has satisfactory title appear in the balance sheet.

I. Use of the Work of a Specialist

1. We agree with the findings of the specialists that we engaged to evaluate the valuation of Property, Plant and Equipment and have adequately considered the qualifications of the specialists in determining the amounts and disclosures included in the consolidated and council financial statements and the underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.

I. Estimates

Property Plan and Equipment and PFI Estimates

1. We believe that the measurement processes, including related assumptions and models, used to determine the accounting estimates have been consistently applied and are appropriate in the context of CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16
2. We confirm that the significant assumptions used in making the Property Plan and Equipment and PFI Estimates appropriately reflect our intent and ability to carry out business functions on behalf of the entity.
3. We confirm that the disclosures made in the consolidated and council financial statements with respect to the accounting estimates are complete and made in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16
4. We confirm that no adjustments are required to the accounting estimates and disclosures in the consolidated and council financial statements due to subsequent events.

J. Retirement benefits

1. On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

K. Additional specific representations:

The Council have taken all necessary action to investigate the fraud in S106 income and we are not aware of any other frauds in this area;

The Council have taken all reasonable action to complete the bank reconciliations in 2015/16 and that there are no other items that require amendment or disclosure. However, there remains an immaterial unreconciled difference and we have undertaken to bring the bank reconciliation back into balance by the end of the 2016/17 financial year.

The Council have provided EY with all necessary information to support the disclosures for the PFI and detailed working schedules to support infrastructure assets.

Yours faithfully,

Alan Cross
Head of Finance

Rachel Musson
Interim Director of Finance

I confirm that this letter has been discussed and agreed at the Audit and Governance Committee on 17 November 2016

Cllr David Stevens
Chair of Audit and Governance Committee